Legislative Audit Division

State of Montana

Report to the Legislature

November 1998

Financial Audit

For the Fiscal Year Ended June 30, 1998

Guaranteed Student Loan Program

Commissioner of Higher Education

We performed a financial audit of the Montana Guaranteed Student Loan Program for the fiscal year ended June 30, 1998. This report contains the audited financial statements and accompanying notes for fiscal year 1997-98. We issued an unqualified opinion on the financial statements. The opinion means the reader may rely on the financial statement information presented.

The current report contains no recommendations to the program. The prior report also contained no recommendations.

Direct comments/inquiries to:
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FINANCIAL AUDITS

Financial audits are conducted by the Legislative Audit Division to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States General Accounting Office. Financial audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

Government Auditing Standards, the Single Audit Act Amendments of 1996 and OMB Circular A-133 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 1999, will be issued by March 31, 2000. Copies of the Single Audit Report, when available, can be obtained by contacting:

Single Audit Coordinator
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James Gillett, Financial-Compliance Audit

November 1998

The Legislative Audit Committee
of the Montana State Legislature:

This is our report on the fiscal year 1997-98 financial audit of the Commissioner of Higher Education's Montana Guaranteed Student Loan Program (MGSLP). The objectives of a financial audit include determining if the program's financial statements present fairly its financial position at June 30, 1998, and the results of its operation for the fiscal year then ended. We tested compliance with state and federal laws that have a direct and material impact on the financial statements. Additional compliance testing for the program is included in our biennial audit of the Office of the Commissioner of Higher Education.

The MGSLP was authorized by the Montana Legislature in 1979 and established July 1, 1980. The MGSLP allows eligible students to receive loans from lending institutions to pay for post-secondary education. The federal government guarantees the loans made by lending institutions and makes administrative cost reimbursements to the MGSLP for acting as a collection agent.

The MGSLP initially contracted with United Student Aid Funds, Inc. to process and service loans. In 1988, the MGSLP began assuming the administrative duties associated with the loan guarantee process. By 1990 the MGSLP assumed complete control, but continues to contract with USA Services, Inc. for computer support services.

As of June 30, 1998, MGSLP has approximately $567,833,864 of outstanding loans that it has guaranteed. MGSLP had a default rate of 4.02 percent. Given the current default rate, the federal government will reimburse MGSLP 98 percent of defaulted loans.

On page A-1, you will find the Independent Auditor's Report followed by the financial statements and accompanying notes. We issued an unqualified opinion which means the reader can rely on the presented information. The program's response to our audit can be found on page B-1.

We thank the Commissioner of Higher Education and his staff for their cooperation and assistance during the audit.

Respectfully submitted,

Scott A. Seacat
Legislative Auditor

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Members of the audit staff involved in this audit were Vickie Rauser and Victoria Murphy.

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Deputy Legislative Auditors:
Jim Pellegrini, Performance Audit
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INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the Balance Sheet of the Commissioner of Higher Education's Guaranteed Student Loan Program - Special Revenue Fund of the state of Montana as of June 30, 1998, and the related Statement of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual for the fiscal year then ended. These financial statements are the responsibility of the program's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in note 1, the financial statements present only the Commissioner of Higher Education's Guaranteed Student Loan Program - Special Revenue Fund and are not intended to present fairly the financial position and results of operations of the state of Montana in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Commissioner of Higher Education's Guaranteed Student Loan Program - Special Revenue Fund of the state of Montana as of June 30, 1998, and the results of its operations for the year then ended in conformity with generally accepted accounting principles.

As discussed in note 17 to the financial statements, the Commissioner of Higher Education's Guaranteed Student Loan Program has changed its method of reporting loans purchased from lenders and federal reinsurance reimbursements.

Respectfully submitted,

James Gillett

James H. Gillett, CPA
Deputy Legislative Auditor

October 1, 1998

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COMMISSIONER OF HIGHER EDUCATION
GUARANTEED STUDENT LOAN PROGRAM
SPECIAL REVENUE FUND
BALANCE SHEET
June 30, 1998

ASSETS	
Cash in Treasury	$2,868,685
Short Term Investments (Note 3)	5,580,254
Interest Receivable	22,102
Accounts Receivable	71,792
Due From Federal Government (Note 2)	2,153,432
Prepaid Expense	100
Securities Lending Cash Collateral (Note 4)	373,714
U S Treasury Notes (Note 5)	1,085,603
Total Assets	$12,155,682
LIABILITIES AND FUND BALANCE	
Liabilities:	
Accounts Payable	$232,738
Liabilities Under Securities Lending (Note 4)	373,714
Property Held in Trust (Note 6)	1,142,916
Due to Federal Government (Note 7)	1,001,322
Deferred Revenue (Note 8)	3,650,859
Total Liabilities	6,401,549
Fund Balance	
Reserved	4,232,183
Unreserved	1,521,950
Total Fund Balance	5,754,133
Total Liabilities and Fund Balance	$12,155,682

The accompanying notes are an integral part of this financial statement.

COMMISSIONER OF HIGHER EDUCATION
MONTANA GUARANTEED STUDENT LOAN PROGRAM
SPECIAL REVENUE FUND
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE
BUDGET AND ACTUAL
FOR THE FISCAL YEAR ENDED JUNE 30, 1998

	Budget	Actual	Variance Favorable/ (Unfavorable)
REVENUE:			
Guarantee Fee Income (Note 8)	$820,567	$1,270,867	$450,300
Administrative Expense Allowance (Note 9)	697,482	750,254	52,772
Investment Earnings (Note 3)	350,000	340,818	(9,182)
Collection Costs Retained (Note 10)	987,584	614,749	(372,835)
Supplemental Preclaims Assistance (Note 11)	229,524	358,441	128,917
Accrued Interest (Note 12)	10,000	38,849	28,849
Nonreinsured Loan Recoveries (Note 13)	15,000	70,541	55,541
Escrow Disbursement Service Fees (Note 6)	60,000	96,040	36,040
Retained FFELP Consolidation Costs (Note 10)	0	408,447	408,447
Retained FDSLP Consolidation Costs (Note 10)	0	748,743	748,743
Reinsurance from Dept of Ed (Note 17)	0	19,120,149	19,120,149
Net Securities Lending Income over Exp.(Note 4)	0	359	359
Miscellaneous Revenue	5,000	6,963	1,963
TOTAL REVENUES	3,175,157	23,825,220	20,650,063
EXPENDITURES:			
Administrative Costs	$3,618,220	$3,538,841	$79,379
Reserve recall expense (Note 6)	0	1,058,046	(1,058,046)
Claims paid to lenders (reinsured) (Note 17)	0	19,120,149	(19,120,149)
Claims paid to lenders (non reinsured)	300,000	301,708	(1,708)
Equipment and Intangible Assets	71,780	25,455	46,325
Debt Service	3,749	4,061	(312)
TOTAL EXPENDITURES	3,993,749	24,048,260	(20,054,511)
Excess Revenues Over/ (Under) Expenditures	(818,592)	(223,040)	595,552
Prior Year Adjustment (Note 16)	0	2,570	2,570
Fund Balance - 07/01/97	5,974,603	5,974,603	0
Fund Balance - 06/30/98	$5,156,011	$5,754,133	$598,122

The accompanying notes are an integral part of this financial statement.

COMMISSIONER OF HIGHER EDUCATION
GUARANTEED STUDENT LOAN PROGRAM
SPECIAL REVENUE FUND
NOTES TO THE FINANCIAL STATEMENTS
FOR FISCAL YEAR ENDED JUNE 30, 1998

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Description of Program

The State of Montana's Guaranteed Student Loan Program (MGSLP) is located in the Office of the Commissioner of Higher Education. As a Special Revenue Fund, it accounts for the proceeds of revenue sources that are legally restricted to expenditures for specified purposes. MGSLP was established by the Office of the Commissioner of Higher Education in fiscal year 1981 to coordinate and administer the federally insured student loans issued by various lending institutions within the State of Montana. Montana's Federal Family Education Loan Program operates in compliance with agreements with the U.S. Department of Education (DE), pursuant to Section 428 of the Higher Education Act of 1965, as amended (The Act).

B. Basis of Accounting

The financial statements were prepared using the modified accrual basis of accounting. Under the modified accrual basis of accounting, expenditures are recorded on the basis of valid obligations. Revenues are recorded when received in cash unless susceptible to accrual. Revenues are susceptible to accrual if they are measurable and available to finance expenditures of the fiscal period or are not received at the normal time of receipt. Revenues are deferred if material and received before the normal time of receipt or if received for a particular activity and the expense for that activity has not been incurred prior to fiscal year end.

2. DUE FROM FEDERAL GOVERNMENT

MGSLP pays individual lending institutions for any loans that have been defaulted or are unpaid due to the death, permanent disability, or bankruptcy of the borrower. The agency then seeks reimbursement from DE in accordance with reinsurance agreements between the agency and DE (See Note 13). MGSLP's claims for reinsurance payments not received as of June 30, 1998, are included here.

In addition, the receivable Due From Federal Government includes amounts MGSLP had not yet received for administrative expense allowance payments (Note 9) for the last two quarters of fiscal year 1998, and supplemental preclaims assistance (SPA) reimbursements (Note 11) for accounts which were satisfactorily brought current and became payable in May and June 1998. The extent of the outstanding reinsurance activity and other pending reimbursements from DE as of June 30, 1998, is shown below.

Reinsurance claims due from DE	$1,976,163
Administrative Expense Allowance for the last two fiscal quarters	109,834
SPA for May and June 1998	67,435
Total Due From Federal Government	$2,153,432

3. INVESTMENTS

Investments are units purchased in the State of Montana's Short Term Investment Pool (STIP) and are reflected at cost, which equals market. At June 30, 1998, MGSLP owned 5,580,254 units valued at $1 per unit for a total of $5,580,254. During fiscal year 1998, MGSLP had investment earnings of $340,818. STIP securities include Banker's Acceptances, Commercial Paper, Corporate Obligations, Montana Certificates of Deposit, Government Securities, and Repurchase Agreements. At June 30, 1998, most securities, classified as Risk Category 1, were held by the state or its agent in the state's name. The remaining portions not classified, were loaned under a security lending agreement with the state's agent.

The State of Montana's STIP investment portfolio contained asset-backed securities and variable rate securities with market values of $460,336,330 and $332,900,172; 40.4% and 28.4%, respectively, of the total portfolio at June 30, 1998, the most recent date figures are available. Board of Investment policy requires that STIP investments have the highest rating in the short term category by at least one of the six Nationally Recognized Statistical Rating Organizations.

Asset-backed securities have less credit risk than securities not backed by pledged assets and market risk for these securities is the same as market risk for similar non asset-backed securities. While variable-rate securities have credit risk identical to similar fixed-rate securities, their market risk is more sensitive to interest rate changes. Market risk may be less volatile than fixed-rate securities because the value of variable-rate securities will usually remain at or near par. There are no legal risks that the Board of Investments is aware of regarding any STIP investments.

4. SECURITIES LENDING

Under the provisions of state statutes, the Board of Investments has, via a Securities Lending Authorization Agreement, authorized the custodial bank, State Street Bank and Trust, to lend the Board's securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. During the period the securities are on loan, the Board receives a fee and the custodial bank must initially receive collateral equal to 102 percent of the market value of the loaned securities and maintain collateral equal to not less than 100 percent of the market value of the loaned security. The Board retains all rights and risks of ownership during the loan period.

During fiscal year 1998, State Street lent, on behalf of the Board, certain securities held by State Street, as custodian, and received US dollar currency cash, US government securities, and irrevocable bank letters of credit. State Street does not have the ability to pledge or sell collateral securities unless the borrower defaults.

The Board did not impose any restrictions during fiscal year 1998 on the amount of the loans that State Street made on its behalf. There were no failures by any borrowers to return loaned securities or pay distributions thereon during fiscal year 1998. Moreover, there were no losses during fiscal year 1998 resulting from a default of the borrowers or State Street.

During fiscal year 1998, the Board and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified plan lenders, in a

collective investment pool, the Securities Lending Quality Trust. The relationship between the average maturities of the investment pool and the Board's loans was affected by the maturities of the loans made by other plan entities that invested cash collateral in the collective investment pool, which the Board could not determine. On June 30, 1998, the Board had no credit risk exposure to borrowers.

5. U. S. TREASURY NOTES

MGSLP has established a separate account with the Montana Board of Investments for the investment of restricted funds as required by the Balanced Budget Act of 1997 (See Note 6). The amount transferred to the restricted fund for fiscal year 1998 was $1,083,047, which includes a $25,001 overage that will be used to reduce the amount to be transferred during fiscal year 1999. These funds are held in U.S. Treasury Notes with a maximum maturity date of September 1, 2002. As of June 30, 1998, the account valuation was $1,085,603, as follows:

Principal	$1,058,000
Premium	$29,349
Amortization	($1,746)
Total	$1,085,603

6. PROPERTY HELD IN TRUST

MGSLP operates an escrow disbursement service for approximately forty lenders. Participating lenders are assessed a fee for this service. In accordance with contracts MGSLP has with the disbursement service lenders, MGSLP automatically debits the lenders' accounts to collect loan proceeds. MGSLP then disburses funds to the schools for delivery to the students either by individual State of Montana warrants or electronic transfers. The MGSLP disbursement service records all adjustments to individual student loan accounts and ensures that school refunds of loan proceeds are promptly returned to the lenders. Disbursement service revenues earned during fiscal year 1998 were $96,040. As of June 30, 1998, MGSLP's disbursement service held $84,870 in student loan funds which were disbursed to the schools or refunded to the lenders after June 30,1998.

In addition, the Balanced Budget Act of 1997, P.L. 105-33, signed August 5, 1997, provides for the U.S. Secretary of Education to recall $1 billion of guaranty agencies' reserve funds on September 1, 2002. Each agency's required share of the total recalled reserve funds has been calculated based on the total reserve fund dollars held by the agency as of September 30, 1996. For purposes of calculation, the reserves include any Federal reserve funds in cash or liquid assets held by the agency. The reserve ratio is defined as the amount of the agency's federal reserve fund as of September 30, 1996, divided by the original principal amount of all outstanding insured loans on that date. In each of the federal fiscal years 1998 through 2002, each guaranty agency must transfer their required share, in equal annual installments, into a restricted account established by the agency, where funds will be held until final transfer to DE on September 1, 2002. Once deposited into the restricted account, an agency may not use the funds for any purpose without the express written permission of the Secretary. The Agency may use

the investment earnings from the restricted account to perform certain default reduction activities, as outlined in the Balanced Budget Act of 1997. At the end of the five year period, the reserve funds in the restricted account will be transferred to DE with a corresponding reduction in net assets. MGSLP's required share of the total recalled reserves is $5,290,229 or approximately 65% of MGSLP's available reserve balance at September 30, 1996. The amount held in trust as of June 30, 1998, was $1,058,046. MGSLP does not anticipate a significant impact to its operations until final transfer of its recalled reserves to DE.

7. DUE TO FEDERAL GOVERNMENT

After assignment to the guaranty agency, MGSLP seeks collection of student loans that have been defaulted. Recoveries of loans reinsured by DE are owed back to DE (See Note 10). In addition, proceeds of loans sold back to lending institutions after a loan is rehabilitated or repurchased are also owed back to DE. At June 30, 1998, the amount owed to DE is $1,001,322.

8. DEFERRED REVENUE AND GUARANTEE FEE INCOME

Guarantee fees are received from borrowers at the time loans are disbursed. In all years prior to fiscal year 1995 MGSLP charged a guarantee fee equivalent to 3% of the loan amount. Effective July 1, 1994, the maximum guarantee fee that borrowers may be charged decreased to 1% of the loan amount. Guarantee fees are deferred and recognized as revenue, using the straight-line method, over an eight year period. This period approximates the average life of an outstanding student loan. Deferred revenues from guarantee fees are invested by MGSLP and are included in the agency's reserves. Deferred revenue at June 30, 1998, is $3,650,859.

Earned guarantee fee income for the fiscal year ending 1998 is made up of the annual guarantee fees received as follows:

Fiscal Year	One-eighth of fees
1991	$ 181,017
1992	203,310
1993	218,329
1994	260,288
1995	107,525
1996	93,045
1997	101,046
1998	106,307
	$1,270,867

9. ADMINISTRATIVE EXPENSE ALLOWANCE

The Omnibus Budget Reconciliation Act of 1993 provides that payment of Administrative Expense Allowance (AEA) is dependent upon federal appropriation on an annual basis. AEA reimbursements are calculated as 0.85% of the total consummated loan guarantees made during the quarter. During fiscal year 1998 AEA payments totaled $750,254, which

includes $109,834 accrued for loan guarantee expense reimbursements which were not received until after June 30, 1998.

10. COLLECTION COSTS RETAINED

MGSLP pursues collection, from the borrower or other responsible party, of defaulted loans held by the agency. The U.S. Secretary of Education is entitled to his equitable share of any recoveries, as determined by the rate of reinsurance on the defaulted loans less an allowance for collection cost reimbursement. The Omnibus Budget Reconciliation Act of 1993 established the agency's collection cost retention rate at 27%. In addition, the Secretary provides the agency with collection costs amounting to 18.5% of the outstanding balance of any defaulted loan held by the agency which is consolidated by the borrower into a Federal Direct Consolidation Loan (See Note 14). During fiscal year 1998 MGSLP retained $1,771,939 in collection costs from loan recoveries and direct loan consolidations.

11. SUPPLEMENTAL PRECLAIMS ASSISTANCE

Supplemental Preclaims Assistance (SPA) is a default prevention measure provided by MGSLP to borrowers that are between 120 and 270 days delinquent on their student loan payments. Delinquent borrowers are contacted to advise them of options available to bring their delinquent accounts current. After a borrower successfully brings his/her account current, DE reimburses MGSLP for its SPA activities. The reimbursement is computed as 1% of the outstanding delinquent account balance brought current. Reimbursements for SPA during fiscal year 1998 were $358,441. This includes $67,435 in reimbursements for supplemental preclaims activity which became payable during May and June 1998 which was not received until after June 30, 1998.

12. ACCRUED INTEREST

During fiscal year 1998 MGSLP purchased claim eligible bankruptcy accounts from lending institutions. If the claim survived the bankruptcy discharge, MGSLP sold the bankruptcy claim back to a lending institution at its outstanding value, including interest which accrued during the bankruptcy proceedings. During fiscal year 1998, accrued interest earned on repurchased bankruptcy accounts was $38,849.

13. CONTINGENCIES

The outstanding principal balance of loans guaranteed by MGSLP as of June 30,1998, is approximately $567,833,864. This amount excludes bad debt, death, disability, and bankruptcy claims which have been previously purchased by the agency.

MGSLP has entered into agreements with DE, dated June 13, 1980, for reinsurance and supplemental reinsurance of loans, in accordance with The Act. These agreements allow for 100% reimbursement by DE for claims due to the death, disability, or bankruptcy of the borrower. Claims due to defaulted loans may be reimbursed by DE for up to 100%. The percent of reimbursement on defaulted loans payable to the agency is dependent upon MGSLP's annual default rate and date of the original loan guarantee. Annual default rates are calculated as the ratio of year-to-date default purchases divided by the original guaranteed amount of loans in repayment status at the beginning of the federal fiscal

year.

MGSLP exceeded the 5% federal fiscal year (ending September 1997) annual default rate in July 1997. Default claims submitted to DE for reinsurance during the remainder of the federal fiscal year were subject to reduced reinsurance. The total loss incurred during the first quarter of fiscal year 1998 as a result of the reduced reinsurance percentage is $134,388. This loss is included in the $301,708 total agency share of loan defaults for the fiscal year 1998.

The following schedule reflects the federal reinsurance rates on defaulted student loans. In the event of extreme future adverse loss experience, MGSLP could be liable for up to 22% of the outstanding loan volume. Since its inception, MGSLP has paid $690,602 in claims, or portions of claim eligible loans, which were not reinsured by DE. During the fiscal year 1998 MGSLP recovered $70,541 of the total outstanding balance of non-reinsured claims held by the agency.

RATE OF ANNUAL DEFAULTS	FEDERAL REINSURANCE Loans made on or prior to 9/30/93	FEDERAL REINSURANCE Loans made on or after 10/1/93
0 to 5%	100%	98%
more than 5% but less than or equal to 9%	90% of claims over 5% but less than or equal to 9%	88% of claims over 5% but less than or equal to 9%
over 9%	80% of claims over 9%	78% of claims over 9%

14. LOSS FROM DEFAULTED LOAN CONSOLIDATIONS

Section 428(c)(6) of The Act provides that a guaranty agency is authorized to retain an amount of any borrower payments received by the guaranty agency on a defaulted loan. The amount retained is equal to the sum of the complement of the reinsurance percentage in effect when the Secretary paid the reinsurance claim plus 27% of the payment amount to cover administrative costs related to collection and default prevention (See Note 10). Under section 428C of The Act, a defaulted borrower is permitted to acquire a Federal Consolidation Loan and apply the proceeds to pay the balance due on his/her defaulted loans.

Although not supported by law or regulation, DE stated that the payoff amount received by a guaranty agency for a defaulted loan included in a Federal Consolidation Loan is not a payment "made by the borrower", as the term is used in section 428(c)(6). DE claimed that The Act did not specifically authorize guaranty agencies to retain any part of the payoff amount on defaulted loans that are consolidated.

MGSLP did not agree with DE's position. MGSLP maintained that DE's interpretation of a payment "made by the borrower" was too narrow and that loan payoffs resulting from consolidation should be subject to agency retention as it is defined in section 428(c)(6) of The Act until a change in regulation or law differentiated an alternate retention rate. The 1996 Amendments to The Act, which became effective July 1, 1997, changed the collection retention rate on default loan consolidation payoffs to 18.5%. During fiscal year

1998, MGSLP was required to pay DE an additional portion of the consolidated, defaulted loan payoff (i.e. the difference between the original retention amount and the 18.5% allowable under The Act). This amount, $185,322, reduced the amount of Collection Costs Retained during fiscal year 1998 (See Note 10).

15. COMMITMENTS

MGSLP is bound by Guarantee Reserve Agreements with the lending institutions participating in the Federal Family Education Loan Program in Montana. These agreements require MGSLP to maintain an amount in the guarantee reserve fund equal to at least 1.0% of the unpaid principal balance of all outstanding loans guaranteed by the agency. MGSLP's Guarantee Reserve Agreement with the Montana Higher Education Student Assistance Corporation (MHESAC), Montana's student loan secondary market, requires that its reserve fund be equal to at least .5% of the unpaid principal balance of all outstanding loans guaranteed by MGSLP.

The Guarantee Reserve Agreement ensures that MGSLP will have sufficient cash available to carry out its reasonably expected obligations on guaranteed claim eligible student loans. As of June 30, 1998, MGSLP was substantially in compliance with all Guarantee Reserve Agreements.

16. PRIOR YEAR ADJUSTMENTS

Prior year adjustments, totaling $2,570, consists of an adjustment to Administrative Expense Allowance revenue earned during fiscal year 1997 which was under-accrued at fiscal year end ($2,733), abatement of interest revenues recorded in fiscal year 1997 ($153), and payment of expenditures incurred in fiscal year 1997 but not paid until fiscal year 1998 ($10).

17. CLAIMS PAID TO LENDERS AND REINSURANCE FROM DE

MGSLP contracted with the Legislative Audit Division to assist in reconciling Federal reports and to make recommendations concerning MGSLP's accounting practices. In fiscal year 1998 MGSLP changed the way it records loans purchased from lenders and the subsequent reimbursement (reinsurance) from DE. The previous practice was to record the loans purchased as a receivable from DE and to relieve the receivable when reinsurance was received. The difference was then recorded as bad debt expense. In fiscal year 1998 MGSLP changed its accounting representation to show the amounts paid as claims and the subsequent amounts received from DE as expenses and revenues respectively. The difference between the amounts paid and the amounts received are reflected as Claims Paid to Lenders (non reinsured). The net effect on the fund balance is identical under both practices.

18. FIXED ASSETS

MGSLP is accounted for on the Statewide Budgeting and Accounting System (SBAS) as a special revenue fund. The fixed assets of MGSLP, which total $118,181 as of June 30, 1998, are valued at cost. MGSLP fixed assets are included in the General Fixed Assets Account Group within the accounting entities of the Office of the Commissioner of Higher Education.

19. COMPENSATED ABSENCES LIABILITY

MGSLP's liability for compensated absences, which totals $121,434 as of June 30,1998, is included in the Long Term Debt Account Group within the accounting entities of the Office of the Commissioner of Higher Education.

20. LEASES

MGSLP has entered into an operating lease for office facilities and a capital lease for a photocopier. The operating lease, which expires in November 2008, had total rental payments during fiscal year 1998 of $133,373.

The balance of the capital lease at June 30, 1998, was $8,365. Total payments to principal during fiscal year 1998 were $2,827.

Future minimum lease payments under the lease agreements as of the end of the previous fiscal year are as follows:

Fiscal Year	Operating	Capital Lease	
Ending June 30	Lease	Principal	Interest
1999	140,875	3,114	635
2000	140,633	3,410	338
2001	140,643	1,841	49
2002	141,100	-	-
2003	140,920	-	-
2004+	759,606		

21. RELATED PARTY TRANSACTIONS

The Montana Board of Regents, which governs MGSLP, is the guarantor of the loans owned by MHESAC. The Board of Regents and MHESAC have four common board members. Approximately 50.51% of MGSLP's outstanding loan volume is held by MHESAC.

MGSLP has an agreement with MHESAC to share certain costs for the lease of computer equipment; computer and software maintenance costs; computer supply, photocopy, and facsimile expenses; and personnel costs for employees of MHESAC who perform services that are of direct benefit to MGSLP. Certain MHESAC personnel are authorized to purchase computer equipment for use by both MGSLP and MHESAC. Costs for these purchases are covered under the shared costs agreement between the two entities. MGSLP also receives certain services from the State of Montana for telephone, postage, and computer supplies which directly benefit MHESAC. MHESAC reimburses MGSLP for these services.

During fiscal year 1998, MGSLP's portion of shared costs reimbursed to MHESAC was $357,694. MGSLP was reimbursed for $192,106 of shared costs by MHESAC, which includes an accrued receivable of $26,180 for reimbursements not received until after June 30, 1998.

22. EMPLOYEES' RETIREMENT SYSTEM

MGSLP employees are covered by the Public Employees' Retirement System (PERS) or the Teachers Retirement System (TRS). Professional employees with contracts under the authority of the Board of Regents are covered by the Optional Retirement Program (ORP), which is available through the Teachers Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF) unless they were previously members of the TRS, in which case they may choose to enter the TRS. The classified staff is provided a retirement program through the Montana Public Employees' Retirement System (PERS).

DEFINED BENEFIT PLANS

Public Employees' Retirement System (PERS).

Established in 1945 and governed by Title 19, chapter 3, MCA, PERS participants are eligible to retire at age 60 with at least five years of service; at age 65 regardless of length of service; or at 30 years of service regardless of age. A reduced retirement benefit may be taken with 25 years of service or at age 50 with a minimum of five years of service. Effective January 1, 1989, monthly retirement benefits are calculated by taking 1/56 times the years of service times the final average salary. Vesting occurs once membership service totals five years. Under PERS, the state contributed 6.800% of an employee's gross wages. The employee contributed 6.800% of his/her gross wages.

Teachers' Retirement System (TRS).

The TRS was established in 1937 and is governed by Title 19, chapter 20, MCA. Teachers Retirement System participants are eligible to retire with a minimum 25 years of membership service or five years of creditable service at age 60. A retirement benefit is 1/60 times the years of service times average final compensation. An employee is vested in TRS following completion of five years of creditable service. Vested employees may retire at or after age 50 and receive a reduced retirement benefit. Under TRS, the state contributed 7.470% of an employee's gross wages. The employee contributed 7.044% of his/her gross wages.

The State's policy is to fund accrued pension costs although unfunded liabilities exist. Based on their most recent actuarial valuation reports, both the PERS and the TRS were actuarially sound.

Trend information, indicating the progress made toward accumulating assets needed to pay retirement benefits when they are due, is not available on an agency basis. This information is available on a statewide basis in the Retirement Systems' annual reports.

RETIREMENT PLAN INFORMATION FOR MGSLP AS OF June 30, 1998

	PERS	TRS
Covered Payroll	$ 889,131	$ 58,000
Total Payroll	959,507	959,507
Employer Contributions	$ 60,461	$ 4,333
Percent of Covered Payroll	6.800%	7.470%

Employee Contribution	$ 60,461	$ 4,086
Percent of Covered Payroll	6.800%	7.044%

23. SUBSEQUENT EVENT

The 1998 Reauthorization of the Higher Education Act created a new federal Student Loan Reserve Fund (FSLRF), which is the property of the U.S. Government. Guaranty agency reserves as of September 30, 1998, shall be deposited in the new FSLRF no later than 60 days after the enactment of the bill. Use of the FSLRF is limited to payment of lender claims and payment of default prevention fees. Guarantors are required to deposit reimbursements from DE into the FSLRF, as well as the portion of default recoveries that equals the complement of the reinsurance rate which is not reimbursed to guarantors by DE, student loan insurance premiums, and Supplemental Preclaims Assistance payments. The required reserve level for the FSLRF will be reduced from .5% to .25%.

The Act also created an Agency Operating Fund (AOF), which is the property of the guarantors. The operating fund is to be used for a variety of FFELP activities and for other student aid related activities as selected by the guaranty agency. The payment guarantors receive from DE for Administrative Cost Allowance, the portfolio maintenance fee, Supplemental Preclaims Assistance fee, and defaulted loan collections are to be deposited in the AOF. There is no required reserve level for the AOF.

In addition, guarantors will be reimbursed from DE at lower rates of 95%/85%/75%, depending on the average default rate of each agency, (reduced from 98%/88%/78%) of the amount they paid the lender for default claims and 100% for all other claims (See Note 13). The Administrative Cost Allowance will be decreased from .85% to .65% based on the new loan volume insured each year. However, a new portfolio maintenance fee of .12% in fiscal year 1999 and fiscal year 2000 and .10% thereafter will be paid to guarantors based on the original principal of all outstanding insured loans each year (subject to certain caps). Guaranty agencies shall retain 24% of the amount collected on defaulted loans, decreasing to 23% beginning October 1, 2003, (reduced from 27%) and shall retain 18.5% of collections on defaulted loans which are consolidated.

During the current fiscal year 1999, MGSLP will continue to analyze the effects of these changes on future operations.

MONTANA GUARANTEED STUDENT LOAN PROGRAM

Mailing Address:
P.O. Box 203101
Helena, MT 59620-3101

(406) 444-6594
FAX (406) 444-1869

Delivery Address:
2500 Broadway
Helena, MT 59601-4989

Customer Assistance (800) 537-7508

OCT

October 28, 1998

Scott A. Seacat
Legislative Auditor
Capitol Station
Helena, MT 59620

Dear Scott:

This letter confirms completion of the Montana Guaranteed Student Loan Program's audit performed by your staff. It is my understanding there were no recommendations.

I want to take this opportunity to thank you and your staff for the thorough and professional manner in which the audit was performed. Please be assured that the staff at MGSLP will continue to evaluate and improve our services to students, lenders and educational institutions. The confidence of lenders and school is of utmost importance if students are to maintain access to private capital.

Sincerely,

Arlene Hannawalt

Arlene Hannawalt
Director